Romanian central bank turning outright hawkish

Latest central bank minutes show concerns are mounting on the inflation front while the economic balance is seen skidding. As usual, the vote to keep the key rate at 2.50% was unanimous

The National Bank of Romania building in Bucharest

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The inflation rate has surprised to the upside so far this year.

Among its main drivers, as emphasised by the National Bank of Romania (NBR) is the ongoing upward pressures on the unit labour costs and a reacceleration of wage hikes. Apparently, the labour market tightness issue has been more thoughtfully studied at the latest central bank meeting, in the context of the historically low unemployment rate and the high number of employees in the economy. The real net wage increase is expected to be in double digits in 2019.

Overall, inflation is seen on a "significantly higher path" than in the February 2019 inflation report, which was predicting a 3.0% inflation in December 2019 and 3.1% in December 2020. Short-term inflation is also seen above the 3.50% upper bound of the target band while the overall risk balance is considered to be tilted to the upside.

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The widening current account deficit has gained even more attention than usual as it suggests "external competitiveness losses of the economy" while its decreased coverage by capital inflows caused "serious reasons for concern by some board members". Net exports are expected to increase their negative contribution to GDP growth. All-in-all, the current account deficit is "posing a concern in terms of the sustainability of economic growth and macro-stability."

Some board members have been unusually blunt concerning the exchange rate. Increased pressure on the exchange rate is seen as "very likely", in the context of a deteriorating external position. As for inflation, the exchange rate impact "would probably be relatively more inflationary than previously anticipated", along with other factors such as aggregate demand and labour costs.

Regarding the latest changes to the bank tax legislation, the unanimous opinion was the amendments satisfy the central bank requirements, but it complicates the monetary transmission.

The need for a tighter monetary policy to anchor deteriorating inflation expectations has not only been hinted but explicitly put forward. For now, it seems that "strict control over money market liquidity" is the "adequate" way to go. However, the "adequate dosage and pace of adjustment of the monetary policy stance" was mentioned again, suggesting the NBR might have some more bullets ready.

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A rate hike might be more seriously considered to anchor inflation expectations if inflation persistently stays above the target band in the second half of 2019.

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